Written Statement for

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On Behalf of:

The National Association of Home Builders

To The

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Hearing On

"The Housing Crisis – Identifying Tax Incentives to Stimulate the Economy"

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I. Overview

On behalf of the approximately 235,000 members of the National Association of Home Builders (NAHB), thank you for the opportunity to testify before the House Small Business Committee for the hearing entitled, "*The Housing Crisis – Identifying Tax Incentives to Stimulate the Economy*." My name is Joe Robson and I am a homebuilder from Tulsa, Oklahoma and NAHB's 2008 National Vice President.

The housing crisis and its contribution to the overall economic downturn are having severe effects on homeowners, state and local governments, and other stakeholders in the housing sector, including businesses connected to housing. The residential construction sector and its related-businesses have been particularly hard hit. This is acutely true for small businesses of which there is great concentration in the housing sector. For example, home building, due to its real estate character and local nature, is dominated by small, regional firms. According to data collected before the downturn, nearly 70% of NAHB's builder-members construct fewer than 25 homes a year. Over two-thirds of NAHB's members have total annual revenue of less than $1 million a year, with 88% generating less than $5 million in total annual revenue.

The recently enacted *Economic Stimulus Act of 2008* may limit the severity of the recession this year and NAHB applauds Congress for passing this important legislation. However, by its nature, this stimulus package is short-lived and does not address the deep problems posed by the housing contraction that are at the root of today's economic and financial market problems. Congress can, and should, do more.

Some have argued that the best way to bring the housing market into balance is to permit housing prices to fall in an uncontrolled fashion over a period of time. However, this path of adjustment would most likely cause substantial collateral damage to the economy, to financial markets, state and local governments, and to America's homeowners. Policymakers should not take that risk. A second round of housing-targeted economic stimulus is urgently needed to complement the *Economic Stimulus Act of 2008* and the monetary policy actions of the Federal Reserve.

Both the House and Senate have taken important steps towards crafting a second stimulus package to address the housing crisis. NAHB urges Congress to finish that work as soon as possible.

The longer that potential solutions linger, the greater the housing crisis will deepen and the more damage that will be done to the nation's economy. This statement presents recommendations for polices that should be incorporated in final housing stimulus legislation to provide the most impact on the housing crisis and to the small businesses of our nation's housing industry.

II. The Housing Crisis and the National Economy

The U.S. housing market now is in the contraction phase of the most severe housing cycle since the Great Depression. Housing construction starts are down by more than 60 percent from 2005, with single-family starts down more than 66 percent since the peak in early 2006. This dramatic contraction has exacted a heavy toll on economic growth and employment during the past two years. Whether or not the economy is in an official recession, there is no doubt that the economy has slowed and the resulting impacts are strongly negative.

Growth of U.S. economic output (real Gross Domestic Product) was estimated at a meager 0.9 percent annual rate in the first quarter of 2008, according to the Commerce Department. Declines in home building directly subtracted 1.17 percentage points from the final GDP number. That is, if home building activity had been flat, GDP growth would have been greater than 2 percent. Due to these declines, home building in 2005 was 6.2% of GDP. Today it is less than 4% of GDP.

Due to the slowing of economic growth, job losses have begun to accelerate. In the residential sector alone, 31,100 jobs were lost in April 2008 according to the Labor Department. Since the peak of total employment in February 2006, 478,000 net jobs have been loss, with more expected due to low levels of home building activity. In general, many home builders are now reporting substantial financial losses when only a few years ago they were generating jobs, providing local development and paying taxes.

The adverse economic impacts of the housing contraction involve not only sharp declines in home sales and housing production, but also involve the depressing effects of falling home prices on household wealth and mortgage credit quality. These events have provoked an alarming surge in mortgage foreclosures that have decreased the homeownership rate, which has fallen from 69.2% in the second quarter of 2004 to 67.8% in the first quarter of 2008.

For homeowners, the accelerating declines in housing prices are the most immediate effect of the current crisis. Housing wealth is the primary source of savings for most households and a key driver of consumer spending. If housing prices fall, homeowners' wealth decreases and consumer spending is negatively affected. As a result, households may decrease current consumption to offset the lost wealth. For these reasons, home prices are an important indicator of the state of the housing market and the potential direction of the overall economy. Home prices are also a base for state and local government property tax revenues.

According to the most recent S&P/Case-Shiller National Home Price Index data, housing prices are falling at annualized rate of 30%. These are historic and unprecedented declines in the value of the assets most American households rely on as the most important source of their families' wealth. The Case-Shiller data reveal that national prices are now down more than 16% from the peak in July 2006, with most economists expecting continuing declines over the coming year.

These future price declines are expected due to the large excess inventory of new and existing homes in the for sale market. Home builders have cut production and inventories of new homes for sale have fallen from approximately 550,000 in the summer of 2006 to approximately 450,000 today according to Census Department data. However, these numbers are likely understated due to cancelled sales that are removed from inventory estimates. Until recently, cancellation rates for builders were well in excess of historical norms. Nonetheless, current Census data indicate that the month-supply estimate of new homes now stands at 10.6 months. In contrast, a healthy new home market would have a number around 5 to 6 months-supply.

Furthermore, events in the housing market have seriously damaged financial institutions holding mortgage assets, as well as companies that provide mortgage credit enhancement. The decline in mortgage credit quality first became evident in the subprime mortgage sector last year. Concerns about subprime mortgages resulted in an overall reevaluation and repricing of risk for all investment assets. For a time, this process essentially shut down or seriously damaged a wide range of securities markets, including major components of the mortgage securities markets in the U.S. The result of these events in the financial markets has been reduced mortgage accessibility for potential homebuyers, which further reduces housing demand and results in additional price declines.

III. The Need for Housing Stimulus and Recommendations

The case for housing stimulus is strong at this time. The record volume of vacant homes on the for-sale market inevitably will continue to put persistent downward pressure on home prices for some time. If housing prices continue to fall significantly, as many economists expect, then households spend less because they feel (and are) less wealthy. One key reason for reduced consumer spending is that housing wealth is the primary source of savings for most households. If housing prices fall, then homeowners' wealth decreases. As a result, households may decrease current consumption to offset the lost wealth.

According to a January 2007 report from the Congressional Budget Office (CBO), a 10 percent decline in housing prices from peak to trough – a conservative estimate of what many economists expect – would reduce consumption and ultimately subtract 0.4 to 2.2 percentage points from Gross Domestic Product (GDP) growth. Given that many economists expect meager growth in GDP for this year, the CBO estimates indicate that falling housing prices can easily push the economy into recession. In dollar terms, the CBO report estimates that a 10 percent housing price decline would subtract $55 to $316 billion from GDP.

Continued downward pressure on home prices also further reduces the quality of outstanding mortgage credit, making it even more difficult to refinance or restructure adjustable-rate mortgages that have encountered or are facing payment resets. These effects, in turn, will worsen the alarming upsurge in mortgage foreclosures; move even more homes onto the for-sale market, put even more downward pressure on house prices and mortgage quality; and stretch out the contraction in new housing production even further. This vicious circle can create the conditions under which the housing market will overcorrect on the downside, imposing huge costs on our nation's homeowners, state and local governments, financial institutions, housing- and construction-related small businesses, and other stakeholders in housing.

In this environment, businesses small and large would benefit from targeted tax stimulus to the benefit of the short-term economic picture and the long-term recovery. In the case of home builders, who are largely small businesses, many are struggling to even stay solvent in the current economic environment. They are taking drastic steps to minimize costs, generate capital and keep their businesses afloat, including laying off workers and raiding personal retirement accounts, just to name a few. Job losses and lost business activity in home building not only harms the economy today, but it significantly weakens the industry's ability to meet the housing need of the nation in the long-term.

A. Homebuyer Tax Credit

With the above in mind, NAHB's foremost recommendation is that Congress create a temporary homebuyer tax credit. House prices and inventories obviously are central to the outlook for the economy and the financial markets. Policies that stimulate home purchases in the immediate future can pay huge dividends and a temporary homebuyer tax credit provides the most bang for the buck. Indeed, the recent revival of interest among prospective buyers suggests that temporary credits could stimulate a wave of home buying that could quickly reduce excess supply in housing markets and halt the dangerous erosion of house prices and mortgage credit quality.

NAHB applauds the work by the House and Senate to include some kind of homebuyer tax credit in their respective housing stimulus packages. Today, I would like to particularly address the model adopted by the House of Representatives in H.R. 3221, the *American Housing Rescue and Foreclosure Prevention Act of 2008*. This approach parallels several principles regarding a homebuyer credit that are of importance to NAHB.

Temporary

A homebuyer tax credit will be effective as a stimulus measure if and only if the credit period were limited, such as a period of twelve months and certainly overlapping the Spring selling season of 2009. If the credit's effective period was too long, or if homebuyers believed the credit may be extended, the stimulative impact the market requires would not be generated. Congress can look to the example of the 1975 homebuyer tax credit for evidence of how a temporary model worked effectively.

Congressional discussion of a homebuyer tax credit could "stall" the housing market as buyers delay purchase in order to receive a possible, future benefit. Thus, it is imperative that sales during the discussion period being retroactively rewarded AND that Congress act with haste. A long policy debate with no action would have negative effects on the housing market.

Credit Large Enough to be Effective

Simple economics dictates that the larger the credit amount, the larger the stimulus. Considering the changes in downpayment requirements and the prices of homes, the House model of $7,500 meets this requirement. Of course, as the process of deliberation on the final form of the credit, NAHB would urge Congress to consider options for increasing the size of the credit to maximize its impact and effectiveness.

Refundable

NAHB analysis of 2005 IRS data indicates that the average first-time homebuyer had an adjusted gross income of $65,000 and tax liability of $5,000. Given this information, an effective tax credit, as described above, must be refundable to have maximum economic impact.

Principal Residences Only

The credit established in H.R. 3221 would only apply for all owner-occupied housing units used as a principal residence, as defined by Section 121 of the tax code. The credit should not be used by speculators or flippers, but rather, should be used to reduce housing inventory, stabilize housing prices, and address housing affordability issues. All housing units used as a principal residence should qualify, including single-family homes, condominiums, cooperatives, and townhouses. NAHB also urges the Congress to ensure that whatever final homebuyer tax credit model is adopted contains a level playing field for purchases of new and existing homes.

First-Time Homebuyers

The homebuyer tax credit model in H.R. 3221 is limited to first-time homebuyers; an approach which NAHB supports. First-time homebuyers constitute approximately 40% of all homebuyers in a given year according to the Census Bureau's American Housing Survey data, although this number has likely fallen recently due to changes in the mortgage markets. Nonetheless, targeting the credit to first-time homebuyers is effective for stimulating housing demand and stabilizing prices because these buyers do not have to sell a home to purchase a home. Moreover, a first-time homebuyer purchase of a starter home frees the seller to purchase a home as well, thereby yielding multiplier effects in the for-sale housing market.

Outstanding Issues - Monetization

Monetizing the tax credit for the purposes of helping a first-time homebuyer accumulate a downpayment is a critical element to maximizing its effectiveness. The most attractive option for monetization would be to allow the taxpayer to file a special return with the IRS upon closing, thereby allowing the tax credit to be used as part of the actual home purchase. If this can not be administratively accomplished, Congress should establish rules or otherwise indicate that third-parties, such as title companies, should be permitted to advance the tax credit, as some tax preparers do today for tax refunds. NAHB supports establishing rules to ensure that monetization occur as quickly and efficiently as possible, with a minimum of administrative expense for the homebuyer.

In conclusion, an effective homebuyer tax credit would increase housing demand, reduce excess inventory of new and existing homes, and stabilize housing prices. NAHB believes that the homebuyer credit model in H.R. 3221 would increase housing sales by several hundred thousand housing units. Due to this increase in housing demand, inventories would fall, housing prices would stabilize, the secondary mortgage market would gain confidence and certainty, and many elements of the current crisis would be successfully addressed.

B. Expansion of the Net Operating Loss Deduction Carryback

Home builders, like many businesses, are now reporting financial losses when a few years ago they were generating jobs, providing local development and paying taxes. For home builders large and small the importance of the ability to claim and carry back net operating losses (NOL) deductions to years when significant taxes were paid cannot be overstated. The inability to do so will result in the need to either increase high-cost borrowing or further liquidate land and homes, which will only compound the existing inventory problem. The additional supply of homes and land on market for sale, of course, will put even more downward pressure on prices and further add to the housing crisis. Ultimately, the result of this will be more layoffs of workers and reduced development of communities.

Current law allows for a two-year carryback of NOLs, however, home builder losses began in 2006. Expanding the carryback of NOLs beyond two to years when significant taxes were paid provides financial resources to the home building sector as well as all businesses to weather the economic downturn. Further, this will help all businesses, including financial institutions and manufacturers, facing difficult economic decisions concerning employment. Finally, an expansion of the NOL carryback simply allows businesses to accelerate their claim of NOL deductions that under present law would be claimed in the future. The need for these deductions today is critical where they can help all businesses with losses weather the economic downturn and emerge from this recession in a position to grow.

C. Temporary Expansion of State Allocations of Mortgage Revenue Bonds

Congress can also help address the current crisis by expanding and modifying the Mortgage Revenue Bond (MRB) program, which uses tax-exempt bonds to finance below-market interest rate mortgages for low- and moderate-income first-time homebuyers. NAHB supports expanding the cap for MRBs by an additional $10 billion, as well as modifying the rules so that state housing finance agencies may use the proceeds of MRBs to refinance troubled mortgages, thereby reducing the number of foreclosures, helping homeowners stay in their homes, and protecting local property prices. NAHB applauds the inclusion within H.R. 3221 of a provision to provide for additional MRG authority.

D. Modernization of the Low Income Housing Tax Credit

The crisis in housing also has impacts on the rental sector, particular that part of the industry that provides affordable housing. The nation's largest affordable housing production program is the Low-Income Housing Tax Credit (LIHTC). Established in 1986, the program has helped finance approximately 80,000 newly constructed affordable housing units annually. However, given the two decades that have elapsed since the program was enacted by Congress, it is important, particularly at this moment, to make a series of technical modifications to modernize the program to ensure its ability to respond to current and future affordable housing needs.

Especially important to NAHB is fixing the method by which area median income (AMI) is determined in order to overcome a set of data and methodological changes that threaten the financial viability of many LIHTC properties. Further, NAHB recommends that the credit percentages of the program be fixed at 9% and 4% respectively in order to provide additional certainty for LIHTC investors and building owners. NAHB strongly supports additional steps taken as part of H.R. 3221 to enhance the LIHTC program.

III. Conclusion

I, and all of the members of NAHB, thank you again for the opportunity to testify today. We appreciate the continued efforts of Congress to address the nation's housing crisis and more importantly to craft effective, workable solutions. Important steps have been taken already and we urge you to move quickly to complete a final bipartisan package that can be signed into law. NAHB looks forward to working with this Committee and the Congress as a whole to meet that objective.